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August 17, 2004

Mary L. Cottrell, Secretary
Department of Telecommunication and Energy
One South Station, 2nd Floor
Boston, MA 02202

Re: D.T.E. 04-60 — Petition of Cambridge Electric Light Company and Commonwealth Electric Company for Approvals Relating to the Termination of Power Purchase Agreements with Pittsfield Generating Company, L.P.

Dear Secretary Cottrell:

Enclosed for filing is the Reply Brief of Cambridge Electric Light Company ("Cambridge") and Commonwealth Electric Company ("Commonwealth"), d/b/a NSTAR Electric ("NSTAR Electric") in the above-referenced proceeding. Also enclosed is a certificate of service.

Thank you for your attention to this matter.

Very truly yours,

Robert N. Werlin

Enclosures

cc: Joan Foster Evans, Hearing Officer
Service List

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Cambridge Electric Light Company/ Commonwealth Electric Company	)	D.T.E. 04-60

CERTIFICATE OF SERVICE

I certify that I have this day served the foregoing document upon the Department of Telecommunications and parties of record in accordance with the requirements of 220 C.M.R. 1.05 (Department's Rules of Practice and Procedures).

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Dated: August 17, 2004

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Cambridge Electric Light Company/ Commonwealth Electric Company	)	D.T.E. 04-60

REPLY BRIEF OF CAMBRIDGE ELECTRIC LIGHT COMPANY AND COMMONWEALTH ELECTRIC COMPANY D/B/A NSTAR ELECTRIC

Submitted by:

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August 17, 2004

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I. INTRODUCTION

Cambridge Electric Light Company ("Cambridge") and Commonwealth Electric Company ("Commonwealth") d/b/a NSTAR Electric ("NSTAR Electric" or the "Companies") file this reply brief to respond to the initial briefs filed by the Attorney General of the Commonwealth (the "Attorney General") and Pittsfield Generating Company, L.P. (formerly known as Altresco Pittsfield, L.P.) ("Pittsfield") in the above-reference proceeding before the Department of Telecommunications and Energy (the "Department").[1] This case was filed by the Companies, pursuant to G.L. c. 164, §§ 1A, 1G, 76, 94 and 94A for approval of: (a) the Termination Agreements between: (1) Cambridge and Pittsfield; and (2) Commonwealth and Pittsfield (collectively, the "Pittsfield Termination Agreements"); and (b) approval of ratemaking treatment relating to the Pittsfield Termination Agreements.

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1 In responding to the Attorney General's initial brief, the Companies will not repeat arguments at length that were addressed in the Companies' Initial Brief. Silence on any matter raised by the Attorney General does not indicate the Companies' agreement to any issue raised by the Attorney General. The Companies expressly reassert the positions and arguments set forth in their Initial Brief.

Although the Attorney General asks the Department to reject the Companies' petition for approval of the Pittsfield Termination Agreements and associated ratemaking treatment, he does not dispute the central facts, analytical methods or legal standards presented by NSTAR Electric. Instead, he argues that the Companies somehow could have achieved even larger mitigation of the existing purchased power agreements with Pittsfield (the "Existing PPAs") had they more aggressively attempted to dispute the manner in which Pittsfield has operated the plant. For the reasons set forth below, the record establishes that NSTAR Electric properly considered all of the issues raised by the Attorney General, and that entering into the Pittsfield Termination Agreements represents a reasonable settlement of the dispute that maximizes mitigation and customer savings. Indeed, the record shows that had NSTAR Electric embarked on the Attorney General's "maximum litigation" strategy, customers would have been significantly harmed. The Department should reject the Attorney General's argument and promptly approve the Companies' petition so that the significant customer benefits can be implemented as soon as possible.

II. THE PITTSFIELD TERMINATION AGREEMENTS MAXIMIZE MITIGATION OF TRANSITION COSTS AND APPROPRIATELY SETTLE ALL DISPUTES RELATING TO THE EXISTING PPAS.

A. Introduction

The Attorney General correctly recognizes that, in considering approval of a proposed buyout of a PPA, the Department applies the same standard of review that it employs when it reviews a settlement agreement. See, e.g., Commonwealth Electric Company (Lowell Cogen Buyout), D.T.E 99-69, at 7 (1999), citing Plymouth Rock Energy Associates, L.P., D.T.E. 92-121-B (1999) and other cases cited in the NSTAR

Electric's Initial Brief (NSTAR Electric Initial Brief at 4-5). In determining whether a buyout of an obligation to purchase electricity is reasonable, the Department considers all costs to customers, including litigation costs and the desire to have electric distribution companies divest their generating assets and PPAs. In Plymouth Rock, supra, the Department determined that the buyout in that case would:

> benefit customers by reducing, to the maximum extent possible, the total amount of transition costs to be paid by customers, and avoiding further time consuming and expensive litigation. Moreover, the Act was designed to move electric companies, such as Commonwealth, out of this prior regulatory regime into a more limited role as distribution service companies, free of generating obligations.

Plymouth Rock, supra, at 5 (emphasis added). The record here shows that approval of the Pittsfield Termination Agreements complies with Department precedent.

As described in the NSTAR Electric's Initial Brief, the Companies engaged in a well-designed, competitive auction process that ensured that all reasonable mitigation options for the Companies' PPAs were considered (NSTAR Electric Initial Brief at 6-9). The Attorney General takes no issue with that process. Nor does the Attorney General take issue with the manner in which Mr. Lubbock evaluated customer savings, i.e., by comparing the net present value of transition cost payments by customers before and after the PPA buyout (Attorney General Initial Brief at 5, n.3). The Attorney General's argument is that the Companies failed to pursue their contract rights under the Existing PPAs and that this failure resulted in less-than-maximum mitigation. The Attorney General is wrong on both counts.

It is uncontested that since September 2003, the Pittsfield plant has been dispatched at a lower-than-historical capacity factor, and that this practice increases the level of transition costs for customers (Attorney General Initial Brief at 5-6; NSTAR

Electric Initial Brief at 12). What is contested by the Attorney General is whether NSTAR Electric took appropriate action with regard to this change in dispatch practice and whether the Pittsfield Termination Agreements represent a reasonable buyout of the Existing PPAs, taking account of the possible dispute on that issue. The Attorney General's arguments that the Companies did not respond appropriately or that the Pittsfield Termination Agreements do not maximize customer mitigation are belied by the record evidence in this case.

After it became apparent that Pittsfield had altered the manner in which it bid its generating output into the power pool beginning in September 2003, NSTAR Electric personnel with responsibility for PPA administration reviewed the terms of the Existing PPAs, conferred with counsel and had informal conversations with representatives of Pittsfield (RR-AG-3). In January 2004, a formal letter was sent to the General Manager of Pittsfield from NSTAR Electric's Senior Contract Administrator (Exh. AG-1-1, Attachment AG-1-1(u)). Pittsfield responded formally in February 2004 (Exh. AG-1-1, Attachment AG-1-1(v)). Subsequently, NSTAR Electric's PPA administration personnel sought and received a written opinion from its attorneys regarding the merits of the dispute (Exh. AG-3-18).

The record is clear that the bidding strategy engaged in by Pittsfield is consistent with the heat rate of the plant and the current market environment for electricity and natural gas (Exh. AG-3-5; Tr. at 54-55). Accordingly, the issue raised by the Attorney General is not whether Pittsfield is acting irrationally from its business or economic perspective, but whether such action is precluded by the Existing PPAs and whether NSTAR Electric properly pursued the matter.

B. The Attorney General's Arguments Regarding NSTAR Electric's Actions in Response to the Change in Capacity Factor of the Pittsfield Facility Are Without Merit.

The Attorney General suggests, incorrectly, that NSTAR Electric did not explore all options with regard to the lower capacity factor of the plant (Attorney General Initial Brief at 8). He suggests that the Companies should have "informed the Department" (id. at 6) or issued a "demand notice" or a formal "notice of default" (id. at 7). In fact, had NSTAR Electric tried to pursue the matter through litigation (rather than negotiate appropriate terms for the Pittsfield Termination Agreements), the procedural mechanism would be to file for arbitration under Article 12 of the Existing PPAs (Exh. NSTAR-CAM-GOL-1 and Exh. NSTAR-COM-GOL-1).[2] As Mr. Lubbock stated, he knew of no "proper channel" at the Department to bring a contract dispute to the Department.[3] Instead of jumping precipitously to costly and time-consuming litigation, the Companies properly evaluated their legal position and finalized negotiation of the buyouts that took into account all issues and provides for a resolution that maximizes mitigation for customers.

NSTAR Electric will not engage in a detailed analysis of the merits of the dispute. Pittsfield's Initial Brief ably states its position,[4] which, at a minimum, underscores the

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2 The Attorney General cites Tenaska/Commonwealth, D.P.U. 91-200 for the proposition that PPA disputes are under the jurisdiction of the Department (Attorney General Initial Brief at 6, n.3). But that claim involved the allegation that Commonwealth improperly failed to comply with Department regulations by refusing to enter into a new, "restated" PPA. Id. at 2. The Tenaska case was not primarily about the interpretation of, or operation under, a PPA for an operating facility.

3 In fact, under the Department's regulations, Qualifying Facilities (and not distribution companies) have a regulatory right to petition the Department if they are aggrieved by actions of the distribution company. 220 C.M.R. 8.08(2).

4 The Companies need not address the substantive contract arguments set forth in the Pittsfield Initial Brief because approval of the Pittsfield Termination Agreements settles the disputed issues.

wisdom of avoiding the customer cost and uncertainty of the outcome of formal litigation. However, a few of the Attorney General's misstatements or misconceptions deserve comment.

First, the Attorney General's implication that NSTAR Electric delayed in raising the issue of capacity factor for four months is not consistent with the record (Attorney General Initial Brief at 6-7). Although it is true that the first written communication about the issue occurred in January, as indicated above, NSTAR Electric had conversations with Pittsfield prior to that letter (RR-AG-3). There was no delay in raising the issue (both internally within NSTAR Electric and with Pittsfield) and considering the impact on customers.

The Attorney General also implies that NSTAR Electric failed to consider options such as terminating the Existing PPAs or attempting to share in any profits Pittsfield may have made in selling gas (Attorney General Initial Brief at 6, 10, n.10). Again, there is no basis for these assertions.[5] The Companies did consider all possible remedies with regard to the dispute and determined, after conferring with counsel, not to pursue termination (RR-AG-4; Tr. at 179). Moreover, the Attorney General has pointed to no contract provision that would require Pittsfield to share in any revenues for the sale of natural

[5] Nor is there any basis for the Attorney General's suggestion that NSTAR Electric could have altered the outcome of the bankruptcy proceeding of USGen New England, Inc. in a way that would benefit the Companies' customers (Attorney General Initial Brief at 6). The Attorney General has not addressed NSTAR Electric's lack of standing in that proceeding (NSTAR Electric had no privity of contract with US Gen New England, Inc.) or how NSTAR Electric would have been any more successful than Pittsfield in blocking US Gen New England, Inc.'s rights to reject contracts under bankruptcy law.

gas.[6]

The Attorney General is also wrong about the impact of the dispute on the evaluation of auction results by NSTAR Electric and its consultant Concentric Energy Advisors, Inc. The Attorney General states that under "certain assumption" the savings are "very small" (Attorney General Initial Brief at 4-5). But as stated in the Companies' Initial Brief, the assumption that this plant could run at a 90 percent capacity factor is totally unreasonable and inconsistent even with the historical capacity factor of the plant (NSTAR Electric Initial Brief at 11-12; Exh. AG-2-2; Exh. AG-2-3; Tr. at 54-55).[7] The customer savings of the Pittsfield Termination Agreements are substantial, even under the unlikely assumption that the plant will be operated at historical capacity factors (80 percent to 86 percent) (Exh. AG-2-3).[8]

Finally, the Attorney General implies that the dispute regarding the capacity factor may have given an advantage to Pittsfield in relation to other potential bidders

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6 The Attorney General's citation to the power exchange agreement between the Companies, Pittsfield and New England Power (Attorney General Initial Brief at 10, n.10, citing Exh. AG-1) is also unavailing. That agreement has no value because it essentially provided for a mechanism to exchange surplus, off-peak power at market rates between the Companies and New England Power Company. That agreement now provides no benefits because New England Power Company no longer has a PPA with Pittsfield and the present NEPOOL market-based pricing structure already accomplishes the intent of the agreement.

7 This unrealistic 90 percent capacity-factor assumption posited by the Attorney General would not even yield the "break-even" analysis shown in Exhibit AG-3-5. NSTAR Electric would need to expend substantial amounts of customer funds to pursue this costly litigation; those costs are not included in any of the exhibits. Given the uncertainty of the result and the lack of customer savings even if successful, it would have been unreasonable for NSTAR Electric to have followed the Attorney General's advice.

8 The Attorney General unfairly characterizes the Pittsfield Termination Agreements as providing "only minor savings" (Attorney General Initial Brief at 8). Although the dollar savings may be smaller than others filed by NSTAR Electric with the Department (D.T.E. 04-61, D.T.E. 04-68), the percentage savings are actually higher than other agreements (compare, Exh. NSTAR-RBH-6, page 1 in each case). The dollar savings for the Pittsfield Termination Agreements are relatively smaller because of the shorter terms of the Existing PPAs and the magnitude of the over-market costs.

(Attorney General Initial Brief at 9-10). Again, the Attorney General's criticisms are off the mark. As described by Mr. Hevert, the Pittsfield bid was clearly the best viable bid (Exh. NSTAR-RBH at 22). Moreover, it is likely that if other bidders were fully informed about the drop in capacity factor and the likelihood that the future capacity factor would be significantly lower than that contained in the historical data that they possessed (Exh. AG-2-21 (CD-ROM) (see Pittsfield Invoices for 2003), any alternative bids would have been less favorable for customers. Therefore, the Attorney General's argument that added knowledge would have improved other bids is without merit.

C. There Are No Errors in the Companies' Corrected Exhibits

In response to discovery questions from the Attorney General, the Companies identified two faulty cells in the Excel spreadsheets used to compute the projected costs under the Existing PPAs for Cambridge (Exh. AG-2-13; Exh. AG-2-14; Tr. at 7-14). These two errors flow through the exhibits of Messrs. Hevert and Lubbock and result in a net increase of the computed savings for the Pittsfield Termination Agreements (Tr. at 13). The Attorney General argues that there may be other errors and that the Companies' petition should not be approved "until the calculations can be independently verified" (Attorney General Initial Brief at 11).

Although the two errors were certainly unfortunate, there is no indication that there are any additional corrections to be made. Both the Attorney General and Department Staff have thoroughly reviewed the exhibits, asked numerous questions in discovery and during hearings, and tested the accuracy of all calculations. The record contains corrected and reliable data upon which the Department can base its decision, and no further verification is necessary or appropriate.

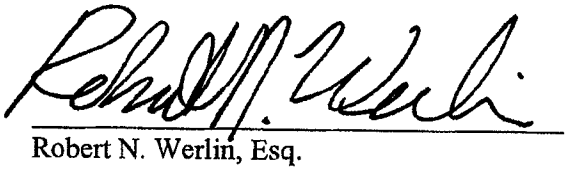
III. CONCLUSION

The Attorney General would have the Department reject the Companies' petition for approval of the Pittsfield Termination Agreements and associated ratemaking treatment, and thereby deprive the customers of Cambridge and Commonwealth of the maximum mitigation of the Existing PPAs. His criticisms have no basis in fact or law and should be rejected by the Department. For the reasons set forth herein and in the Companies' Initial Brief, the Department should approve the Companies' petition.

Respectfully submitted,

CAMBRIDGE ELECTRIC LIGHT COMPANY
COMMONWEALTH ELECTRIC COMPANY

By Their Attorneys,



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